CARLING O'KEEFE LIMITED · ANNUAL REPORT 1986

COVER *(from left to right)*
Availability — as of April 15, 1986

O'KEEFE'S EXTRA OLD STOCK, *malt liquor*	B.C., Alta., Sask., Man., Nfld., N.W.T., Yukon
CALGARY, *lager*	Saskatchewan
COLT 45, *lager*	Saskatchewan
STANDARD LAGER, *lager*	Manitoba
CARLING PILSENER, *lager*	British Columbia
KRONENBRÄU 1308, *lager*	British Columbia
ALTA 3.9, *light beer*	Alberta
MILLER HIGH LIFE, *lager*	B.C., Alta., Sask., Man., Ont., Quebec, N.B., N.S., P.E.I., Nfld., N.W.T., Yukon
MILLER LITE, *light beer*	B.C., Alta., Sask., Man., Ont., Quebec, N.B., N.S., P.E.I., Nfld., N.W.T., Yukon
CARLSBERG, *lager*	Ont., Quebec, N.B., N.S., P.E.I., Nfld.
CARLSBERG LIGHT, *light beer*	Ont., Quebec, N.B., N.S., P.E.I., Nfld.
CARLSBERG GOLD, *malt liquor*	Ontario
FOSTER'S LAGER, *lager*	Ontario
O'KEEFE LÉGÈRE, *light beer*	Quebec
TRILIGHT, *extra light beer*	Alta., Sask., Man., Ont.
O'KEEFE ALE, *ale*	Ontario, Quebec
OLD VIENNA, *lager*	Alta., Sask., Man., Ont., N.W.T.
OLD VIENNA LIGHT, *light beer*	Alberta, Saskatchewan, Manitoba
TOBY, *lager/ale*	British Columbia, Ontario
CHAMPLAIN, *porter*	Quebec
BLACK HORSE, *lager*	Newfoundland
DOW, *ale*	Quebec
CARLING BLACK LABEL, *lager*	B.C., Alta., Sask., Man., Ont., Quebec, N.W.T., Yukon
CINCINNATI CREAM, *lager*	British Columbia, Yukon
DOMINION ALE, *ale*	Newfoundland
KINGSBEER, *lager*	Ontario

CARLING O'KEEFE LIMITED

ANNUAL REPORT

1986

SUMMARY OF OPERATIONS

	1986	1985	1984
BEER			
Sales–hectolitres	5,179,000	5,668,000	6,254,000
Sales revenue	$832,928,000	$833,449,000	$869,287,000
WINE			
Sales–hectolitres	217,000	222,000	226,000
Sales revenue	$ 54,618,000	$ 57,731,000	$ 59,348,000
OIL AND GAS			
Sales–gas (10^3 m^3)	141,000	143,000	129,000
–oil and other (m^3)	98,000	87,000	82,000
Sales revenue	$ 25,107,000	$ 23,376,000	$ 19,831,000
CONSOLIDATED			
Sales revenue	$912,653,000	$914,556,000	$948,466,000
Earnings before extraordinary item	$ 1,054,000	$ 15,694,000	$ 54,320,000
Earnings (loss) after extraordinary item	$ (19,680,000)	$ 15,694,000	$ 54,320,000
Earnings (loss) per common share			
Before extraordinary item	(4)¢	63¢	$2.40
After extraordinary item	$(1.00)	63¢	$2.40
Dividends per common share	48¢	46¢	37¢

CONTENTS

Report to the Shareholders

The business climate during the fiscal year ended March 31, 1986 continued to be most challenging for Carling O'Keefe Limited and its subsidiary companies.

The Canadian beer industry entered the second year of what might be termed a new era, with no sign of a lessening in competitive pressures nor an improvement in industry profitability. Additionally, the Canadian wine and the oil and gas industries added their own dimensions of turmoil to the overall business climate. Within this spectrum, the fiscal year ended March 31, 1986 was not without its difficulties for Carling O'Keefe, but it was one from which we believe we can look ahead to brighter prospects.

FINANCIAL RESULTS

Consolidated earnings before an extraordinary item were $1,054,000 for the year, compared to $15,694,000 for the year ended March 31, 1985. The excess cost of investment in subsidiaries over the underlying net tangible assets (goodwill) of $20,734,000 was written off as an extraordinary item, resulting in a loss for the year of $19,680,000 or $1.00 per common share after preference dividends. Consolidated sales revenue was $912,653,000, compared to $914,556,000 in 1985.

The results included the effects of lengthy work stoppages in the Canadian beer industry, disruption of shipments in Ontario and to the United States following the work stoppage during March of last year, and higher depreciation and interest charges generated by the capital expenditure programme. The pricing structure in the oil and gas industry collapsed on a worldwide basis during the fourth quarter, and the Ontario wine industry experienced serious declines and product write-offs when government regulatory bodies generated adverse publicity over the presence of ethyl carbamate in some fortified wine products.

Capital expenditures during the year were $76,288,000. The Toronto brewery expansion has essentially been completed and is now in operation. All other major capital programmes have been completed, and canning facilities are now present in all planned production areas. The beer company is now in a solid position to meet or create changes in the area of packaging innovation.

During the year, the Corporation utilized its long term line of credit, as well as some of its short term borrowing facilities. The remaining sinking fund debentures were called for redemption and the Corporation was released from the covenants under their trust indentures. While borrowings were higher than they have been in the past, the Corporation's debt to equity ratio was 33:67, an acceptable level.

The annual dividend rate on the common shares has been maintained at 48¢ per share. The Corporation is confident that earnings will improve and that the cash flow provided by operations will be more than adequate to meet expenditure requirements.

OPERATING ENVIRONMENT

The subsidiary companies are having to meet the challenge of far more numerous and frequent changes in their respective operations. Considerable change has occurred in the Canadian beer company, as a result of the move to private mould bottles and aluminum cans. This has affected productivity, efficiencies, distribution and material handling to a greater degree than envisioned.

Changes have occurred in the market place with the introduction of packaging innovations, new brands and other elements. However, the potential of free trade as a disruptive element could prove devastating, even with the elimination of agricultural sourcing requirements and interprovincial distribution limitations. In the meantime, imports from the United States into Alberta and British Columbia, at unreasonably low prices, have dramatically affected the profitability of the beer industry in those provinces and are a portent of the economic scenario that the entire Canadian industry would face if north/south trade barriers were eliminated.

Changes are proposed in the distribution of beer and wine in the Province of Ontario, which would make these products available in grocery stores. The Canadian wine industry might benefit from higher sales volume, but at the expense of higher distribution costs. The brewers could also see some increase in volume, but there would be

a substantial increase in distribution and handling costs, and these cost increases would have to be passed on to the consumer in the form of higher selling prices as in other comparable provinces.

Dramatic changes have occurred in world oil prices. Prices have fallen approximately 60% over a very short period in an industry that is based on a long term investment philosophy. The impact on the oil and gas industry is more immediate than the economic benefits that may ultimately flow through the economy from these price changes. The negative influence on the oil and gas industry has been widely publicized, but the realities have yet to be felt throughout the Canadian economic environment. The loss of revenues at all levels of government is substantial and compounds their deficit problems. The curtailment of capital expenditures is both rapid and dramatic in the western provinces, but takes longer to affect the suppliers to the industry and, ultimately, the suppliers of consumer products and all other consumer services.

Inflation has remained at a relatively low level, while interest rates have declined. Labour settlements were achieved, albeit at a heavy cost, but should provide some stability to the Canadian beer industry over the three year term of most contracts.

STRATEGIES

The Canadian beer operations have had extensive modernization and expansion of production facilities, particularly in Toronto, Calgary and Vancouver. Carling O'Keefe Breweries is now in the position of having very good production facilities, but relatively low capacity utilization. Development of additional sales volume is critical to the achievement of increased profitability, and this will be accomplished through marketing innovation, more efficient spending and the exploitation of market opportunities that present themselves as product or line extensions. The company is well positioned in certain segments of the market, and will continue to develop these areas of strength while introducing new products.

The improvement in the level of profitability for the Corporation is of the utmost importance. Improvement in the earnings from the beer and wine operations is anticipated, although the return on capital employed will still be at an unacceptable level, due in part to the level of profitability of both of these industries. The contribution from the oil and gas operations will be reduced substantially, and will affect the recovery in consolidated earnings in fiscal 1987. It is the Corporation's strategy to continue to assess the present deployment of its assets and to redirect them in the event that suitable opportunities present themselves for an improvement in return on capital employed.

OUTLOOK

The Canadian economy generally has been enjoying reasonable growth for the past year and this is expected to continue, except in areas related to the oil and gas sector. The growth, as usual, is dependent on the United States economy, which has been buoyed by consumer confidence. The Canadian economy has had the benefit of high automobile sales and residential construction, but other segments have not benefitted. Natural resources and agricultural commodities have suffered, due partially to the high value of the dollar compared to other currencies.

Stable inflation rates and lower interest costs should help maintain economic growth, while the recent decline in the value of the dollar currencies should make Canada and the United States more competitive in the export markets. The spectre of government deficit financing continues to haunt the economy, as it is generally felt that the various levels of government have not sufficiently attacked the crux of the problem. The threat of even higher taxation, therefore, remains a strong possibility, despite its negative effect on the economy as a whole.

Carling O'Keefe Breweries should return to a more acceptable level of earnings without the burden of work stoppages. Productivity improvements should materialize without the disruption of the modernization and expansion projects, and with more experience in the handling of private mould bottles and cans. While the depreciation and financing costs of the recent brewery expansion programme will remain for the near term, the programme has provided modern facilities capable of producing a wide variety of containers and packages. New products were distributed late in March 1986. It is recognized that volume gains in the major Canadian markets must be achieved through an improvement in market share, as the industry is not expected to experience any significant real growth over the long term.

Century Importers will continue to invest marketing dollars in order to develop sales volume. Now that a constant supply of products is assured, a revised marketing approach to the United States market, combined with a revitalized organization, should generate a positive trend once more.

Beamish & Crawford is expected to continue to develop its growing lager brands volume, particularly Carlsberg and Carling Black Label. Competition is increasing as more brands become available, but the company's volume trend is a strong one and should continue to overcome competitive efforts.

Jordan & Ste-Michelle Cellars has a difficult year ahead, as it endeavours to regain some profitability from its wine operations. At the same time, it will be developing and marketing additional cider related products, particularly for export to the United States. Changes in the pricing structure in the important Ontario market, and the possible extension of wine sales in grocery stores, will provide an opportunity to increase profitability and sales volume.

Star Oil & Gas will have a substantial decrease in earnings with the world oil price at its present low levels. Capital expenditures have been based on cash flow and, accordingly, will be reduced substantially. The exploration programme will be put on hold until a firmer pricing structure emerges, and expenditures will be limited to maintaining the company's present operations.

The industries in which your Corporation participates experienced turmoil over the past year. Our priority is to improve profitability, as we cope with the pressures generated by the changes in the business environment.

DIRECTORS

During the year, Mr. R.L. Beatty and Mr. J.H. Devlin resigned as Directors of the Corporation. The Board wishes to thank them for their long and distinguished service to the Corporation.

The Honourable W.M. Kelly and Mr. P.J. Fennell were appointed as Directors of the Corporation. Senator Kelly is Chairman of the Board of Rothmans Inc. and Mr. Fennell is President and Chief Executive Officer of that company.

APPRECIATION

The Board of Directors would like to record its appreciation of the efforts of all the employees of the Corporation, throughout a year of considerable change in all the segments of our business. To manage these changes has required flexibility and resolution, which all our employees and suppliers have provided in good measure. With the continued efforts of all these people, I am sure the shareholders can look forward to improved results in the future.

S. Roderick McInnes

Chairman, President and Chief Executive Officer

May 21, 1986

Review of Operations

BEER OPERATIONS–CANADA

Year Ended March 31	1986	1985	1984
Sales–hectolitres	4,834,000	5,340,000	5,990,000
Sales revenue	$765,022,000	$778,746,000	$824,103,000
Earnings before interest and income taxes	$ 2,553,000	$ 4,821,000	$ 70,938,000
Earnings per hectolitre	53¢	90¢	$11.84

It has been a particularly difficult year for the Canadian beer industry.

Industry sales volume decreased 3% compared to last year, due in part to industry wide labour disruptions in Newfoundland and Alberta. The Newfoundland dispute lasted from April 2 to November 17, 1985. In Alberta, the work stoppage was from May 7 to July 13, 1985. Industry sales were lower in all provinces except Ontario, where the volume was distorted by the restocking after the four week work stoppage, which had ended on March 25, 1985.

The industry's profitability for the year was adversely affected by these work stoppages. Labour contracts are now in place in all provinces, with the earliest expiry date being December 31, 1987, and the company expects to benefit from a period free from lengthy work stoppages.

The sales volume of Carling O'Keefe Breweries of Canada Limited was lower in all provinces, compared to 1985, reflecting both the decline in the overall industry volume and a lower market share. Market share in Quebec was higher than last year, but other provinces were lower, reflecting new brand launches and other marketing initiatives by competitors. Exports to the United States were lower, as a result of production disruptions due to the Ontario work stoppage and the installation of new equipment at the Toronto brewery.

Competition in the industry remains intense. Each national, regional and import brewer continues to compete for increased share of market. During the year, in line with changing consumer preferences, competitive activities focused on product introductions, brand entries and packaging changes and innovations. Carling O'Keefe Breweries participated in these activities.

The company converted the majority of its brands from the standard industry compact bottle to a private mould twist off bottle during the year. The consumer has come to expect twist off bottles, and the compact bottle is now used only for minor or low priced brands in the Western Provinces.

Can sales increased over last year, reinforcing expectations of continued growth. Consumers have shown their preference for beer in aluminum cans. The share of market for can sales exceeded 20% of packaged beer sales in the Provinces of Ontario, Alberta and British Columbia during the summer of 1985. Carling O'Keefe Breweries is well positioned with its can production capabilities to meet any anticipated sales demand in the coming year. By the end of the year, the company had installed canning lines in all plants, except Saskatoon, including facilities to can in larger sizes in Montreal, Toronto and Vancouver. The company is now fully competitive in can packaging, having the widest selection of brand and package sizes, and has the flexibility to react quickly to competitive changes in the can market and innovate, where it is practical to do so.

Three new brands were introduced in specific provincial markets across the country. In March 1986, Old Vienna Light was introduced in Alberta, Saskatchewan and Manitoba, and received an enthusiastic response. Foster's Lager, in a distinctive private mould bottle and in cans, was distributed in Ontario during the last two weeks of March 1986, in readiness for its official launch in April 1986. Foster's Lager is produced under license from Carlton & United Breweries Limited of Australia, and initial consumer response has been excellent. Cincinnati Cream was launched in British Columbia in October 1985, using on-premise sampling in the Provincial Liquor stores, which was permitted for the first time. During the year, national distribution was achieved for Miller Lite, following its introduction late in fiscal 1985, utilizing the slogan "Tastes great–and less

filling". Development of this well known brand continues, supported both on television and with sports promotions.

The company's sales revenue was $765,022,000, which was 1.8% lower than last year. Selling price increases were obtained in all provinces, including passing on numerous tax increases imposed during the year. These increases were generally sufficient to recover unit cost increases.

Price discounting in British Columbia and Alberta continued in the fiscal year, fuelled by low priced imported beer from the United States. The industry is extremely concerned about the continuing favourable treatment of imported beers by the Liquor Boards in British Columbia and Alberta at the expense of the Canadian producers. The losses incurred by the industry, particularly in Alberta, are unacceptable and efforts are underway on various fronts to restore profitability.

Earnings from operations for the year reflected lower sales volume, the effect of work stoppages, the bottle sorting costs for private mould bottles, rationalization costs and the effect of the capital expenditure programmes. The start-up costs of introducing new equipment and new packaging, together with production interruptions as a result of all the construction activity, have been quite onerous.

The extensive capital investment programme to increase brewing, bottling and canning capacity and to replace old equipment was essentially completed during the year. Since the programme's completion, concerted effort has been given to training all employees on operations and maintenance. These actions have resulted in steady progress in plant productivity and efficiency levels. This summer will be the first opportunity to utilize the new equipment under high volume conditions.

In any industry, as issues are addressed, new issues surface to replace them. The Canadian beer industry is no exception, and it faces a number of very significant ones. Free trade, the potential expansion of beer distribution in Ontario, low priced beer imports and high taxes represent some of the key issues. The company and the Canadian beer industry have made presentations to the Federal and provincial governments regarding the negative effects on the Canadian beer industry of free trade, particularly the effect of interprovincial shipping restrictions and the artificially high pricing of agricultural ingredients. Expanded beer distribution will increase distribution costs, including cash requirements for trade receivables, trucks and warehouses and, therefore, higher prices or lower taxes will be needed. Low priced imports and increasing taxes on beer continue to have an adverse effect on the profitability of the Canadian beer industry. Carling O'Keefe Breweries is prepared to deal with these issues and challenges, and will continue to seek open dialogue with governments to reach acceptable solutions.

A considerable number of organizational changes have been initiated to develop and implement new strategies and to improve sales volume and profitability. Changes included the creation of a separate product development group to plan and implement new brands and related products. The company has also established a brand management structure to provide a better focus on the company's national and regional brand strengths.

Prospects for the coming year are positive for Carling O'Keefe Breweries. Significant costs associated with work stoppages and with new equipment and packaging changes will not recur in the coming year. Sales enthusiasm for new brands introduced by the company will have a full year's positive impact on operating performance. Strict control of costs and maximization of benefit from dollars spent will be effected. The profitability of Carling O'Keefe Breweries will improve significantly in 1987.

BEER OPERATIONS—IRELAND

Year Ended March 31	1986	1985	1984
Sales—hectolitres	345,000	328,000	264,000
Sales revenue	$67,906,000	$54,703,000	$45,184,000
Earnings before interest and income taxes	$ 3,991,000	$ 3,333,000	$ 2,105,000
Earnings per hectolitre	$11.57	$10.16	$7.97

Beamish & Crawford plc had another very satisfactory year, and reported increased sales volume, sales revenue and earnings.

The industry sales volume was marginally higher than last year, and the trend to lager products continued at the expense of ale and stout. The company's gain in market share reflected a significant increase in the sales volume of lagers. The improvement in sales volume is even more gratifying, considering that last year's volume included the benefit from a five week strike at a major competitor. The company has started to export Beamish Stout to England, which has raised the company's profile and provided additional favourable publicity. Sales revenue and earnings in Canadian dollars increased significantly from last year, as the average exchange rate for translation purposes was 16% higher than that used for the prior year.

The improvement in sales volume has created production difficulties for the brewery. The brewery is located in the centre of the City of Cork. Additional fermentation and storage tanks were installed this year, and plans have been developed to better utilize some of the older buildings in the brewery. As volume continues to grow, the company has been planning to move the warehousing and distribution function from the site, to provide additional space for the further expansion of the brewing facilities when needed in the future.

With the trend to lagers continuing, Beamish & Crawford is in a good position to compete effectively and gain further market share. Although the Irish economy is still not buoyant, inflation is down to 4%, its lowest level in seventeen years, and there are signs of further improvement which will provide more stability and opportunity for growth.

INTERNATIONAL DIVISION

Royalty income from the sale of Carling Black Label in overseas markets, where it is produced under licence, was $1,896,000, compared to $1,496,000 and $1,459,000 in 1985 and 1984 respectively. The rate of royalty and the favourable exchange factors on conversion of pound sterling royalties to Canadian dollars more than offset a decline in sales volume.

WINE OPERATIONS

Year Ended March 31	1986	1985	1984
Sales–hectolitres	217,000	222,000	226,000
Sales revenue	$54,618,000	$57,731,000	$59,348,000
Earnings (loss) before interest and income taxes	$ (2,328,000)	$ 3,225,000	$ 5,596,000
Earnings (loss) per hectolitre	$(10.73)	$14.53	$24.76

The total wine market in Canada grew by approximately 4% during the year, comparable to the increase last year. Sales of table wines continued to outperform other segments of the market, having a 0.6% increase in volume from a year ago. The volume of white table wine continued its growth trend, by increasing approximately 2%, accounting for 66% of all table wine sales, compared to 64% last year. The refreshment beverage category of cooler-type products had a 5.3% market share, up 3.6% from last year. All other category segments declined from the previous year.

Sales volume of Canadian produced wines, including the refreshment beverage category, increased 1%, and now hold 46% of the total market. Wine products, excluding refreshment beverages, decreased 1% from the previous year to 43% of the total wine market. The wine segment of the market continued to be under considerable downward pressure, as imported products remained very competitively priced, despite the strengthening of certain foreign currencies compared to the Canadian dollar. Some European countries have significant wine surpluses and complex forms of subsidies for agricultural based products, which have resulted in low selling prices. These low prices prevented Canadian producers from increasing their selling prices and, therefore, Jordan & Ste-Michelle Cellars Ltd. was unable to fully recover cost increases. Unfair foreign subsidies will continue to adversely affect sales of Canadian produced wine during the coming year, although this may be alleviated to some extent by the recent decline in the Canadian dollar relative to European currencies.

The company's sales volume declined 2.3% from last year. Volume gains were reported in Saskatchewan, while Manitoba and the Maritime Provinces remained unchanged. In the company's major markets of Ontario and British Columbia, wine sales declined significantly, reflecting price competitiveness and Liquor Board ordering patterns. In addition, the negative effect of publicity in December 1985 regarding the possible dangers of ethyl carbamate in some higher alcohol, or fortified, wines was most untimely, and adversely affected sales volume for the last four months of the fiscal year. Coola Bianca sales were substantially higher, as the product was on the market for the whole year. Sales of non-alcoholic sparkling apple juice doubled, and initial shipments of cider for the United States market contributed positively to volume, while domestic cider volume was virtually unchanged.

The company's share of the national wine market declined, reflecting a lack of full participation in the growing Quebec market; a reduction in listings in Alberta, due to the closure of the Calgary winery in September 1985; and generally lower sales in other provinces. Wine sales volume represented approximately 66% of total volume, with coolers and ciders representing the balance.

Jordan & Ste-Michelle continued its programme of developing a complement of brands, which can be advertised on a national basis. Spumante Bambino, Maria Christina, Toscano and Interlude have responded well to this approach. Initial response to Maria Christina Dry, which was launched in Ontario and British Columbia, has been positive and this dry wine will complement the current semi-dry product, which is the best selling Canadian table wine in Ontario. Coola Bianca and Growers Cider also followed this approach during the year. Innovative draught kegs for Growers Cider were introduced last year and are responding well in the licensee trade. Growers Cider has been very successful in British Columbia, and the Ontario rollout of the brand met first year sales projections. A twelve pack of Growers products was launched in British Columbia during the year and has good consumer acceptance. Sales of Monticello, a non-alcoholic sparkling apple juice, have been increasing and the brand shows good potential.

Sales revenue declined from last year, as a result of lower volume and a change in the sales product mix. The refreshment beverage segment is less profitable on a per litre basis than wine. Price increases to recover higher costs of raw materials, employee compensation, production and sales taxes and manufacturing expenses were difficult to obtain, due to competitive pricing practices. Direct manufacturing

cost increases were held to inflation rates, while marketing expenses were higher than last year, as a result of increased advertising and start-up expenses for a major cider launch into the United States. The Calgary winery was closed, and a reorganization of the company was undertaken to compete more efficiently in the market place. As a result of new Federal guidelines, instituted on December 9, 1985, the company made a provision for some sherry inventory which may be unsaleable. The operating loss for the year reflected the effect of these non-recurring costs.

Labour contracts were successfully negotiated in St. Catharines for the plant clerical staff and the two Surrey plant locals. These contracts cover a two year period and expire on December 31, 1987. The Ontario retail store contract runs to December 31, 1986 and the St. Catharines plant contract expires on March 31, 1987.

The company has encountered many problems in the last twelve months. However, progress has been made in the pricing of wines in Ontario; potential volume improvements can be expected should wine sales be permitted in grocery stores in Ontario; and additional volume in the refreshment beverage segment can be anticipated, both in Canada and the United States. These changes, together with the elimination of non-recurring costs, should allow the company to return to operating profitability.

OIL AND GAS OPERATIONS

Year Ended March 31	1986	1985	1984
Sales – gas (10^3 m^3)	141,000	143,000	129,000
– oil and other (m^3)	98,000	87,000	82,000
Sales revenue	$25,107,000	$23,376,000	$19,831,000
Earnings before interest and income taxes	$11,560,000	$10,015,000	$ 9,089,000

The past year has been one of turmoil for the Canadian petroleum industry. During the 1985 calendar year, industry activity reached record levels, with more wells drilled than in any other year. Industry expenditures for exploration, development and production facilities were up 18% over 1984 calendar year expenditures. The activity was sustained by stable prices, increasing exports of crude oil and natural gas to the United States, and the enactment of favourable legislation by the Federal Government and producing provinces.

During the first few months of the 1986 calendar year, however, industry activity has been severely curtailed because of the dramatic drop in the world price of crude oil. Crude oil available from foreign suppliers has dropped from U.S. $26 per barrel in January 1986 to a current price range of U.S. $12 to $15 per barrel. Prices paid to Canadian producers reflect world prices. The rapidly changing prices have removed the stability that there may have been in the industry.

The drop in oil prices was caused by the collapse of the production quota system of the Organization of Petroleum Exporting Countries (OPEC). OPEC members, because of the surplus of available world oil, had restricted production to hold prices near U.S. $30 per barrel. Saudi Arabia decided to increase its production by selling at below prevailing prices, in order to regain its share of market. The result has been a worldwide price war, with all producing countries attempting to maintain markets through competitive pricing.

During the year, recognizing change was occurring, governments provided incentives to maintain drilling activity and help industry cash flow. These incentives included reduction in Alberta Crown royalties, an increase in the amount claimable under the Alberta Royalty Tax Credit and royalty free periods for production from certain new wells. As a result of a larger decline in prices than was anticipated, further temporary programmes are being implemented or considered to help petroleum and related service industry companies survive. The Alberta Government is refunding 95% of the Crown royalties (to a maximum of $3,000,000) paid from April 1, 1986 to December 31, 1986. The Federal Government is considering an amendment to the Petroleum and Gas Revenue Tax (PGRT) on oil and gas revenues. Other incentives are expected to be announced in the near future. There is growing concern that failure to maintain a vital domestic industry will jeopardize Canada's energy future. The decline in prices has had a very significant negative impact on cash flows and earnings for the industry.

Star Oil & Gas Ltd. had a satisfactory year, despite the drop in the oil price during the last quarter of the fiscal year. Production volume of crude oil increased, and natural gas sales were comparable to the previous year. Sales revenue and earnings before interest and taxes increased by 7% and 15% respectively over the previous year.

Production of crude oil and natural gas liquids averaged 268 m^3 (1,685 barrels) per day before royalties, an increase of 12% over last year. The increased volume resulted from a waterflood at Mitsue in Alberta, together with new wells at Steelman and Benson in southeast Saskatchewan and at the Deck field in Texas. A net increase in the company's reserves was achieved through the drilling programme and a revision to previous quantity and royalty estimates.

Natural gas production averaged 387 10^3m^3 (13,730 mcf) per day before royalties, a 1% decrease from last year. Decline in existing wells was not offset by new production, as the company concentrated its exploration and development activities on oil plays.

Capital spending on exploration, development and production facilities totalled $10,655,000, approximately the same level as last year. The company continued to purchase land inventory for the long term by acquiring an interest in 7,445 hectares (18,613 acres) of petroleum and natural gas leases in Saskatchewan, Alberta and British Columbia.

The company limited its activities in the United States to participation in oil development drilling in the Deck field in Texas. During the year, Star's investment in the United States was written down by $544,000 (1985–$1,060,000). The write-down was the result of revisions to reserve volumes and the decline in world oil prices, which reduced the economic value of the reserves.

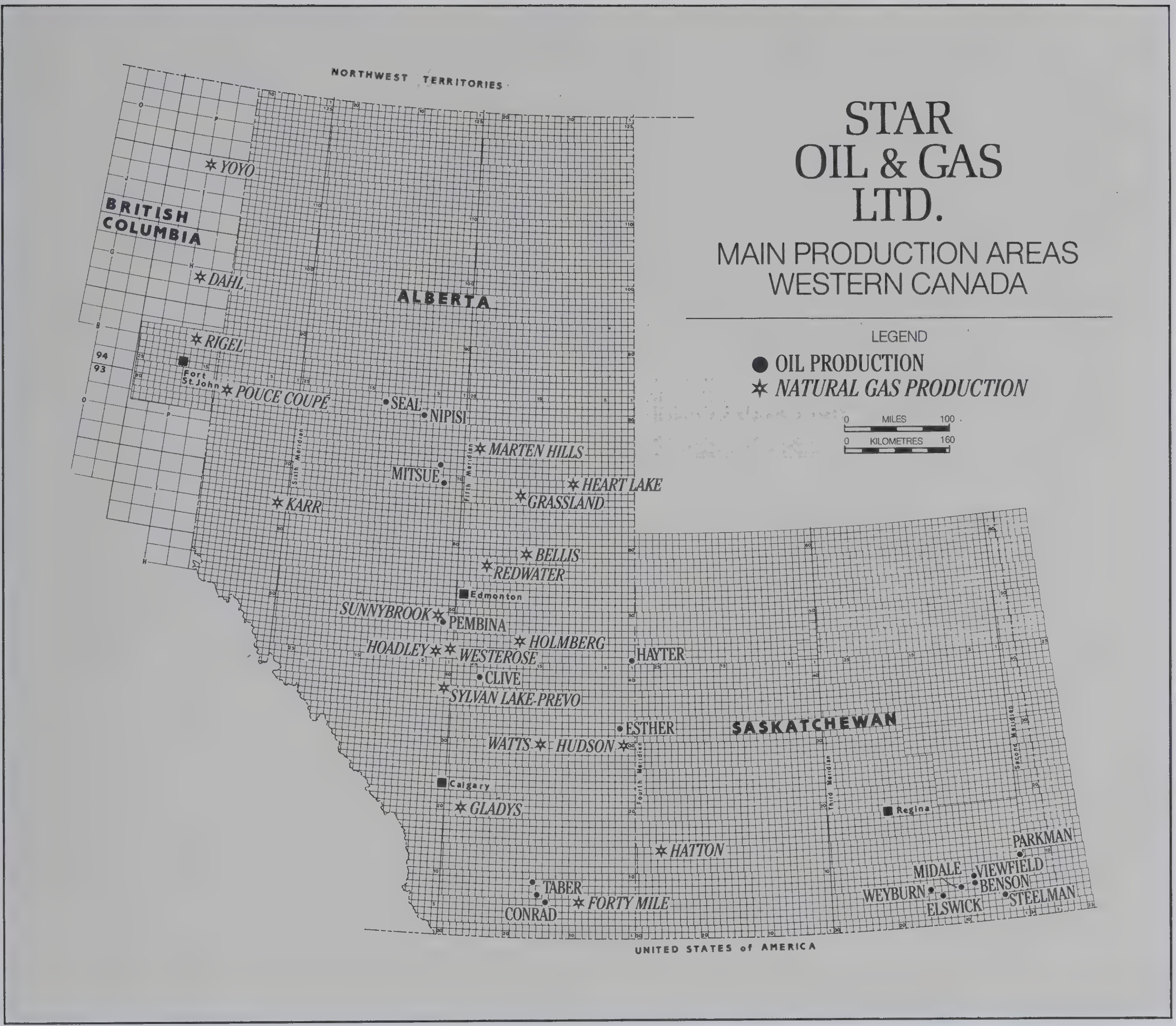
The company will review the value of its properties each quarter, in accordance with the United States accounting rules for oil and gas companies using the full cost accounting method. At year end, Star's Canadian properties had a value greater than the carrying value. Deregulation of natural gas pricing on November 1, 1986 for the Canadian market will have an effect on the value of the company's properties, but whether or not the expected drop in gas prices will result in a write-down will have to be determined at that time.

During the current fiscal year, the company plans to reduce its capital spending substantially. Capital projects will be limited to those that are needed to maintain the company's interest in high quality leases, natural gas contract areas and producing properties. Construction has started on facilities to produce and process natural gas at Pouce Coupé, Alberta, with production expected to begin in August 1986. If prices increase, expanded exploration and development activities may be considered. However, based on current prices and taxation levels, cash flow and earnings from operations are expected to be substantially lower next year.

As at March 31, 1986, Star held an interest in gross and net hectares of land as follows:

	PROVED			UNPROVED		
	Gross	Net	Royalty*	Gross	Net	Royalty
CANADA						
Alberta	48,775	14,872	18,297	103,693	26,260	1,282
British Columbia	3,052	957	1,388	37,313	10,831	406
Saskatchewan	46,186	17,624	400	35,180	22,024	48
Eastcoast Offshore	–	–	–	–	–	36,585
Total Canada	98,013	33,453	20,085	176,186	59,115	38,321
UNITED STATES						
Alaska	2,072	28	–	–	–	–
Kansas	259	24	–	–	–	–
Montana	259	16	–	4,200	4,200	62
North Dakota	163	32	–	649	206	–
Oklahoma	1,648	228	–	77	16	–
Pennsylvania	299	30	–	–	–	–
Texas	1,282	269	16	793	459	–
West Virginia	320	51	–	–	–	–
Wyoming	146	36	356	7,268	1,686	610
Total United States	6,448	714	372	12,987	6,567	672
TOTAL	104,461	34,167	20,457	189,173	65,682	38,993

*The company is paid a royalty from 3% to 15% of production income from producing wells drilled by other companies at no cost to Star.



DRILLING ACTIVITY

	1986			1985		
	Working Interest Wells		Royalty Interest Wells*	Working Interest Wells		Royalty Interest Wells*
	Total	Share		Total	Share	
CANADA						
Gas	16	8.12	3	23	10.22	4
Oil	19	9.98	9	16	8.61	7
Dual zone oil and gas	–	–	–	1	0.12	–
Dry and abandoned	4	1.39	3	7	4.17	6
	39	19.49	15	47	23.12	17
UNITED STATES						
Gas	–	–	–	1	0.13	–
Oil	7	1.83	–	–	–	–
Dry and abandoned	–	–	–	3	0.70	1
	7	1.83	–	4	0.83	1

*Drilled at no cost to Star under agreements with other companies.

RESPONSIBILITIES FOR FINANCIAL STATEMENTS

MANAGEMENT

Management is responsible for the preparation of the consolidated financial statements of Carling O'Keefe Limited and for their integrity and objectivity. The statements have been prepared on the historical cost basis in accordance with Canadian generally accepted accounting principles, which conform in all material respects with international standards, and which have been applied on a consistent basis, except for investment tax credits as described in Note 2. The significant accounting policies followed are described in Note 1 to the financial statements.

Management is further responsible for maintaining a system of internal accounting controls, designed to provide reasonable assurance that the books and records reflect the transactions of the Corporation and that its established policies and procedures are carefully followed. The system is continually reviewed for its effectiveness and is augmented by written policies and guidelines, the careful selection and training of qualified personnel and a programme of internal audit.

AUDITOR

Price Waterhouse is appointed by the Shareholders as Auditor to examine the consolidated financial statements of Carling O'Keefe Limited and report thereon. Its examination is conducted in accordance with generally accepted auditing standards and includes a review of internal accounting controls and tests of transactions. The report of the Auditor appears on Page 23.

AUDIT COMMITTEE

The Board of Directors, through the Audit Committee of the Board, reviews with Price Waterhouse the scope of its audit and the accounting principles to be applied in financial reporting and is responsible for assuring that management fulfills its responsibilities in the preparation of the financial statements. The Audit Committee, which is composed entirely of non-employee Directors, meets regularly with Price Waterhouse, representatives of management and internal auditors to review the activities of each and to ensure that each is properly discharging its responsibilities. To ensure complete independence, Price Waterhouse has full and free access to meet separately with the Audit Committee, to discuss the results of its examination and its opinion on the adequacy of internal accounting controls and the quality of financial reporting.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS

The following analysis and explanatory comments relating to the operations of the Corporation should be read in conjunction with the consolidated financial statements, financial summaries and information on operations by segment, which are provided elsewhere in this report.

RESULTS OF OPERATIONS

Consolidated earnings from operations before an extraordinary item decreased during the fiscal year ended March 31, 1986, reflecting lower sales volume and profit margins in the Canadian beer and wine operations. Beer is the Corporation's principal business, and in 1986 it contributed 91% of consolidated sales revenue and 41% of earnings from operations before interest and income taxes. The level of contribution of beer operations to consolidated sales revenue has remained fairly constant over the three year period. The contribution to earnings from beer operations was 41% in 1986, 38% in 1985, and 83% in 1984, reflecting the downturn in the Canadian beer operations. The consolidated return on average capital employed increased slightly in 1986 to 7.5%, as the effect of deferred income taxes is not included.

Effective April 1, 1985, the Corporation prospectively changed its accounting policy for recording investment tax credits to conform to revised generally accepted accounting principles in Canada. The impact on fiscal 1986 results was to reduce earnings by $2,628,000.

An extraordinary charge of $20,734,000 was recorded in 1986 to write off the excess cost of the Corporation's investments in subsidiary companies over their underlying net tangible assets.

For 1986, the average rate for translation of the operating results of Beamish & Crawford plc was 16% and 9% higher than for 1985 and 1984 respectively.

INCOME

Consolidated sales revenue decreased by $1,903,000 in 1986, compared to a decrease of $33,910,000, or 4%, in 1985 and an increase of $164,239,000, or 21%, in 1984. The reduction in sales revenue in 1986 and 1985 was due to lower sales volume, offset by increased selling prices. In 1984, more than half of the increase in sales revenue was attributable to higher sales volume. The Corporation's share of the Canadian beer market declined in 1986 and 1985. The industry volume declined 3% in 1986, but was relatively unchanged in 1985 and 1984. The decline in 1986 resulted primarily from industry wide work stoppages in Newfoundland for over seven months and in Alberta for two months. Increased selling prices were required to cover increased production and sales taxes and higher manufacturing, marketing, distribution and administrative costs.

Investment and other income during the period reflected fluctuations in royalties received, the amount of funds available for short term investment

and a reduction in the amount of discount recorded on the receivable from the sale of trade marks.

COSTS

Operating costs in all segments of the business reflected the general rise in cost of materials and services purchased, employee compensation and the effect of changes in sales volume.

Production and sales taxes decreased by $4,160,000, or 1%, in 1986, compared to a decrease of 2% in 1985 and an increase of 22% in 1984. The changes reflected increased rates of taxation, as the major portion was indexed, and changes in sales volume.

Raw materials and manufacturing costs increased by $1,567,000, compared to increases of $25,087,000, or 9%, in 1985 and $43,742,000, or 19%, in 1984. Costs during the period reflected fluctuations in sales volume, and higher unit costs for packaging materials and employee compensation. In 1986, costs included the effect of the work stoppages, the commissioning costs for new plant and equipment, higher packaging costs related to canned beer and increased fixed overheads resulting from the brewery expansions. Costs in 1985 and 1984 included a provision of $20,600,000 and $6,600,000 respectively for the write-off of compact bottles. Wine operations in 1986 included a provision of $646,000 for inventory, which may be unsaleable due to the presence of ethyl carbamate. Oil and gas assets in the United States were written down by $544,000 and $1,060,000 in 1986 and 1985 respectively.

Marketing and distribution costs increased by $1,433,000, or 1%, in 1986, which compared to increases of 5% and 24% in 1985 and 1984 respectively. The level of marketing expenditures was reduced in 1986, as a result of lower sales volume in the Canadian beer company. Costs during the three year period reflected the increased competition in the beer industry for specific marketing vehicles related to sports activities and costs related to the introduction of new brands. Distribution costs reflected higher employee compensation and energy costs, as well as the effect of changes in sales volume and the costs related to sorting of returnable private mould bottles.

Administrative and general costs increased by $6,090,000, or 15%, compared to 9% and 5% in 1985 and 1984 respectively. Costs in 1986 included provisions for employee severance and relocation costs of $2,971,000, provision related to the closure of the Calgary winery of $746,000, higher professional fees and general cost increases. The 1985 increase reflected the cost of a strengthened management organization in the beer operations, increased computer development and general inflationary increases.

Interest costs have increased significantly during the period, reflecting the borrowings necessary to finance the major capital expenditure programme of the Canadian beer operations and the purchase of private mould bottles. The average interest rate on borrowings for fiscal 1986 was 9.8%, which was lower than for the previous year.

It should be noted that results of operations from one quarter to the next are not comparable, nor are they indicative of annual results, due to the seasonal nature of the alcoholic beverage industry, which traditionally has greater sales and earnings in the summer months. The fourth quarter of 1986 included provisions for employee severance costs, increased interest expense and a higher income tax provision, due to the change in the accounting treatment for investment tax credits. The third quarter of 1985 and the fourth quarter of 1984 included provisions for the write-off of compact beer bottles. The lower earnings in the fourth quarter of 1985 reflected a reduced contribution from the Canadian beer operations, which resulted from lower sales volume, lower gross profit per hectolitre and increased marketing expenditures.

FINANCIAL POSITION

Consolidated net current borrowings at March 31, 1986 were $30,451,000, compared to net cash of $1,273,000 at the end of fiscal 1985. A comparative consolidated statement of changes in financial position appears on Page 17.

In 1986, the Corporation utilized cash of $80,104,000 in its operations. Higher non-cash items included in costs and income taxes increased the amount of cash generated by operations, despite the reduction in earnings. However, cash was utilized in the operations, due to the capital expenditure programme and operating working capital requirements. In 1985, cash of $59,164,000 was utilized, due to the capital expenditure programme, offset by some release of funds from operating working capital. In 1984, cash utilized in operations was $7,815,000, as higher earnings were sufficient to finance most of the increase in operating working capital and the capital expenditure programme.

The long term borrowing facilities of $125,000,000 were drawn down as planned during 1986 and 1985, in order to finance the brewery capital expenditure programme and the purchase of returnable private mould bottles.

Consolidated working capital, excluding net cash, used in the Corporation's operations increased in 1986 by $57,802,000, following a decrease of $19,779,000 in 1985 and an increase of $11,875,000 in 1984. An analysis of these changes is shown on Page 18. The current ratio at March 31, 1986 was 1.3:1, compared to 1.1:1 in 1985 and 1.4:1 in 1984.

Fluctuations in sales revenue during the period did not result in a comparable change in accounts receivable. Changes in beer sales volume in Ontario do not result in comparable changes in receivables, as sales are made direct to the consumer for cash. Income taxes recoverable reflected the significant levels of capital expenditures, which result in accelerated depreciation for income tax purposes, together with fluctuations in earnings. The inventory value in 1986 included the cost of acquiring returnable private

mould bottles to replace the compact bottles, which had been written off in 1985.

Accounts payable and accrued liabilities fluctuations reflected the relative levels of marketing and capital expenditures in the fourth quarter of each year, together with higher production volume in 1984. In addition, as in previous years, increases have occurred, due to higher unit costs for packaging materials and marketing costs. The 1984 amount included the $6,600,000 provision for the write-off of surplus compact beer bottles. Commencing in 1985, the liability due to customers for deposits on returnable containers was recorded, reflecting the change from the industry compact bottle to company owned private mould bottles.

Capital expenditures for the year were $76,288,000, compared to $124,457,000 in 1985 and $73,800,000 in 1984. The 1986 expenditures were net of investment tax credits of $4,691,000. The major capital expenditures during the period were in the Canadian beer operations, with significant expenditures to renew and expand production capacity at the breweries in Vancouver, British Columbia; Calgary, Alberta; and Toronto, Ontario. The Toronto expansion project was essentially completed during fiscal 1986, at a total cost of approximately $90,000,000. Details of capital expenditures by business segment are provided on Page 25.

The Corporation has projected consolidated capital expenditures of approximately $36,000,000 for the 1987 fiscal year. The reduced level of capital expenditures in 1987 will reflect the completion of the major expansion programme in the Canadian beer operations and a reduction in oil and gas expenditures.

Lines of credit have been arranged which are considered to be adequate to meet the anticipated borrowing requirements for the coming year. During fiscal 1985, the Corporation entered into bank loan arrangements for $125,000,000 of floating rate revolving credits, which mature at the earliest in fiscal years 1988 and 1989, and which may be periodically extended. As at March 31, 1986, this facility had been drawn down.

The Corporation reduced its other long term debt by redeeming the outstanding sinking fund debentures.

The unfunded liability for pensions reflected the improvement in the actuarial value of the assets in the pension plans, together with changes in the actuarial assumptions, including a change in the assumed rates of return in determining present value. The actuarial market value of the Canadian pension fund assets exceeded the accrued benefit liabilities as at December 31, 1985. However, the Beamish & Crawford plans had an unfunded vested liability for past service of $1,965,000, which has been recorded in long term liabilities and as a deferred charge.

The Corporation's cash flow during a year follows the seasonality of the beer operations, which have higher sales in the summer months and in the December holiday season. During the winter period, maintenance programmes and capital projects are carried out to coincide with reduced brewing activities. In addition, there is a cash flow fluctuation within each month, due to the timing of receipts and payments, which gives a relatively favourable cash position at month end.

IMPACT OF INFLATION

The Canadian Institute of Chartered Accountants (CICA) has recommended the inclusion on an experimental basis of supplementary information relating to current cost. The method advocated by the CICA emphasizes the maintenance of operations at the present level and configuration using today's costs for property, plant and equipment, inventories and financial liabilities.

Future decisions regarding the replacement of property, plant and equipment and the manner of replacement will be made in light of economic, regulatory, technological and competitive conditions existing at the time. Replacement or modification of operating assets may occur, when or if required, provided profitability is sufficient to support the replacement cost. The assumption of maintaining operating capability is particularly questionable in the context of the oil and gas operations. The location and extent of reserves are unique and, once depleted, cannot be exactly replaced. Even if new reserves could be found, the current cost of finding the equivalent reserves would be difficult to quantify.

The Corporation recognizes that its production facilities were acquired over a number of years and that any adjustment to reflect current cost information would result in a significant increase in the value of property, plant and equipment and a corresponding increase in the depreciation charge for the year. Due to the nature of the business, inventories and cost of products sold would increase only marginally if current costs were used.

The CICA also recommends disclosure of certain financing related adjustments which reflect the favourable impact of maximizing net monetary liabilities in an inflationary period. The Corporation believes these adjustments are difficult to understand, have questionable validity and detract from the basic objectives of current cost reporting.

The Corporation has decided not to participate publicly in the CICA experiment, as it believes the results prepared using the CICA methodology are of questionable relevance and usefulness.

CARLING O'KEEFE LIMITED

(INCORPORATED UNDER THE LAWS OF ONTARIO)

CONSOLIDATED STATEMENT OF EARNINGS

(IN THOUSANDS OF DOLLARS)

	YEAR ENDED MARCH 31		
	1986	1985	1984
INCOME			
Sales revenue	$912,653	$914,556	$948,466
Investment and other income	3,678	3,600	6,512
	916,331	918,156	954,978
COSTS			
Production and sales taxes	323,209	327,369	335,134
Raw materials and manufacturing	305,763	304,196	279,109
Marketing and distribution	229,440	228,007	216,169
Administrative and general	45,692	39,602	36,162
Interest on long term debt	9,974	1,578	522
Other interest	2,191	707	237
	916,269	901,459	867,333
EARNINGS BEFORE INCOME TAXES	62	16,697	87,645
Income taxes (Note 10)			
Current	(27,842)	(7,063)	23,581
Deferred	26,850	8,066	9,744
	(992)	1,003	33,325
EARNINGS FROM OPERATIONS BEFORE EXTRAORDINARY ITEM	1,054	15,694	54,320
EXTRAORDINARY ITEM (NOTE 3)	(20,734)	–	–
EARNINGS (LOSS) FOR THE YEAR	$ (19,680)	$ 15,694	$ 54,320
EARNINGS (LOSS) PER COMMON SHARE FOR THE YEAR			
Preference share dividends	$ (1,996)	$ (2,011)	$ (2,022)
Earnings (loss) for the year applicable to 21,762,295 common shares outstanding	$ (21,676)	$ 13,683	$ 52,298
Before extraordinary item	(4)¢	63¢	$2.40
After extraordinary item	$(1.00)	63¢	$2.40

CARLING O'KEEFE LIMITED

CONSOLIDATED BALANCE SHEET

(IN THOUSANDS OF DOLLARS)

	MARCH 31 1986	MARCH 31 1985
ASSETS		
CURRENT ASSETS		
Cash and short term investments	$ 4,171	$ 4,334
Accounts receivable	52,405	48,566
Income taxes recoverable	26,217	9,730
Inventories (Note 4)	122,759	97,273
Prepaid expenses	8,395	8,430
Total current assets	213,947	168,333
PROPERTY, PLANT AND EQUIPMENT (NOTE 5)	571,663	500,757
Less accumulated depreciation and depletion	173,002	153,169
	398,661	347,588
OTHER ASSETS (NOTES 3 and 6)	18,871	38,969
	$631,479	$554,890
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Bank indebtedness and notes payable	$ 34,622	$ 3,061
Accounts payable and accrued liabilities	84,971	101,466
Due to customers for returnable containers	20,630	21,532
Production and sales taxes	19,572	18,053
Dividends payable	3,109	3,113
Total current liabilities	162,904	147,225
LONG TERM LIABILITIES (NOTE 7)	128,030	67,892
DEFERRED INCOME TAXES	87,256	59,780
COMMITMENTS AND CONTINGENT LIABILITIES (NOTE 11)		
SHAREHOLDERS' EQUITY		
Capital stock (Note 9)		
Preference shares	41,270	41,520
Common shares	78,357	78,357
	119,627	119,877
Retained earnings	131,840	163,863
Cumulative translation adjustments	1,822	(3,747)
Total shareholders' equity	253,289	279,993
	$631,479	$554,890

APPROVED BY THE BOARD

S. Roderick McInnes, C.A., Director

William J. M. Henning, Q.C., Director

CARLING O'KEEFE LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(IN THOUSANDS OF DOLLARS)

	YEAR ENDED MARCH 31		
	1986	1985	1984
CASH PROVIDED BY (USED FOR) OPERATIONS			
Earnings from operations before extraordinary item	$ 1,054	$ 15,694	$ 54,320
Items included in earnings not requiring an outlay of cash			
Depreciation, depletion and amortization	24,749	20,044	14,964
Deferred income taxes	26,850	8,066	9,744
Other	881	412	629
Cash from operations	53,534	44,216	79,657
Decrease (increase) in operating working capital	(57,802)	19,779	(11,875)
Disposal of property, plant and equipment and other assets	1,742	1,672	1,031
Additions to property, plant and equipment	(76,288)	(124,457)	(73,800)
Additions to other assets	(1,290)	(374)	(2,828)
Cash provided by (used for) operations	(80,104)	(59,164)	(7,815)
CASH PROVIDED BY (USED FOR) FINANCING AND INVESTMENT ACTIVITIES			
Current portion of other assets	1,187	1,797	–
Long term liabilities – net	59,786	60,074	(2,868)
Dividends			
Preference shares	(1,996)	(2,011)	(2,022)
Common shares	(10,446)	(10,011)	(8,052)
Purchase of preference shares	(151)	(146)	(144)
Cash provided by (used for) financing and investment activities	48,380	49,703	(13,086)
(DECREASE) IN NET CASH	(31,724)	(9,461)	(20,901)
NET CASH AT BEGINNING OF YEAR	1,273	10,734	31,635
NET CASH AT END OF YEAR	$ (30,451)	$ 1,273	$ 10,734
Comprised of			
Cash and short term investments	$ 4,171	$ 4,334	$ 11,705
Bank indebtedness and notes payable	(34,622)	(3,061)	(971)
	$ (30,451)	$ 1,273	$ 10,734

Operating working capital consists of working capital excluding cash, short term investments, bank indebtedness and notes payable.

CARLING O'KEEFE LIMITED

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

(IN THOUSANDS OF DOLLARS)

	YEAR ENDED MARCH 31		
	1986	1985	1984
Balance at beginning of year	$163,863	$160,087	$115,735
Earnings (loss) for the year	(19,680)	15,694	54,320
Excess of carrying value over cost of preference shares purchased for cancellation	99	104	106
	144,282	175,885	170,161
DIVIDENDS			
Preference			
$2.20 per Series A share and $2.65 per Series B share	1,996	2,011	2,022
Common	10,446	10,011	8,052
	12,442	12,022	10,074
Balance at end of year	$131,840	$163,863	$160,087
Dividends per common share	48¢	46¢	37¢

CONSOLIDATED ANALYSIS OF CHANGES IN OPERATING WORKING CAPITAL

(IN THOUSANDS OF DOLLARS)

	YEAR ENDED MARCH 31		
	1986	1985	1984
Accounts receivable	$ (3,839)	$ (2,061)	$ 1,371
Income taxes recoverable	(16,487)	(9,202)	(20,897)
Inventories	(25,486)	2,443	(22,253)
Prepaid expenses	35	(1,685)	(1,356)
Accounts payable and accrued liabilities	(16,495)	10,515	30,039
Due to customers for returnable containers	(902)	21,532	–
Production and sales taxes	1,519	(1,302)	1,028
Dividends payable	(4)	432	651
Change in cumulative translation adjustments	3,857	(893)	(458)
Decrease (increase) in operating working capital	$ (57,802)	$ 19,779	$ (11,875)

CARLING O'KEEFE LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES

The financial statements are prepared on the historical cost basis in accordance with accounting principles generally accepted in Canada, which conform in all material respects with those in the United States, except as disclosed in Note 12.

Principles of Consolidation

The principal operating subsidiaries are listed on Page 32. Purchase accounting has been followed for all acquisitions. For certain subsidiaries acquired prior to April 1, 1974, the excess of the cost of shares over the value of the underlying net tangible assets at the time of acquisition was carried at cost and was not amortized. Intangible assets acquired subsequently were amortized over periods not exceeding forty years. (Note 3)

Inventories

Inventories of beverage products, materials and supplies are stated at the lower of average cost and net realizable value. Returnable containers are recorded at amortized cost, which is lower than new replacement cost.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Depreciation is provided on the straight line basis at the following rates per annum:

Buildings	2½%–6⅔%
Machinery and equipment	6⅔%–10%
Motor vehicles	10%–25%

Oil and gas assets are accounted for using the full cost method, whereby all costs of exploration and development are capitalized on a country by country basis. Such capitalized costs, net of amortization, cannot exceed net revenues from estimated future production of proved reserves at current prices and costs and the estimated fair market value of properties. Costs are amortized against income using the unit of production method based on proved oil and gas reserves.

Gains or losses on disposal of brewery, winery and significant oil and gas assets are included in earnings.

Other Assets

Other assets are recorded at cost or amortized cost. Sports franchises are amortized over periods not exceeding forty years.

Pensions

Current service costs are charged to operations as they accrue. Prior service costs arising from amendments to the plans and actuarial gains or losses are charged to operations generally over periods which approximate estimated service lives.

Marketing Costs

Marketing costs, including those related to the introduction of new brands, are charged to operations during the year in relation to sales and are expensed by the end of the year in which the cost is incurred, except for the costs of certain rights which are deferred and amortized over the terms of the respective contracts.

2. CHANGE IN ACCOUNTING POLICY

Effective April 1, 1985, the Corporation prospectively changed its accounting policy for investment tax credits to conform with the recommendations of the Canadian Institute of Chartered Accountants. For the year ended March 31, 1986, investment tax credits have been deducted from the cost of the related fixed assets. In prior years, the net investment tax credits were accounted for as a reduction of income tax expense (Note 10). The change reduced the earnings for the year ended March 31, 1986 by $2,628,000 (12¢ per common share).

3. EXTRAORDINARY ITEM

The unamortized excess cost of shares of subsidiary companies over the value of the underlying net tangible assets at acquisition of $20,734,000 was written off due to the permanent impairment of the value of those investments.

4. INVENTORIES

	1986	1985
Beverage products, finished and in process	$ 52,414,000	$ 47,523,000
Materials and supplies	29,541,000	27,633,000
Returnable containers	40,804,000	22,117,000
	$122,759,000	$ 97,273,000

In 1985, a provision for the write-off of compact bottles of $20,600,000 was charged to raw material and manufacturing costs and deducted from the amortized cost of returnable containers in inventory.

5. PROPERTY, PLANT AND EQUIPMENT

	1986		1985	
	Cost	Accumulated depreciation and depletion	Cost	Accumulated depreciation and depletion
Land	$ 9,264,000	$ –	$ 9,164,000	$ –
Buildings	154,004,000	34,568,000	138,593,000	31,788,000
Machinery and equipment	271,487,000	89,045,000	228,983,000	78,448,000
Motor vehicles	23,878,000	11,902,000	21,727,000	10,901,000
Oil and gas assets	108,424,000	34,178,000	97,773,000	29,677,000
Leasehold improvements	4,606,000	3,309,000	4,517,000	2,355,000
	$571,663,000	$173,002,000	$500,757,000	$153,169,000

6. OTHER ASSETS

	1986	1985
Sports franchises, less amortization $2,302,000 (1985-$1,971,000)	$10,942,000	$11,273,000
Deferred charges and other investments	7,929,000	6,668,000
Cost of shares of subsidiaries in excess of underlying net tangible asset value at acquisition, less amortization (Note 3)	–	21,028,000
	$18,871,000	$38,969,000

7. LONG TERM LIABILITIES

	1986	1985
Sinking fund debentures		
Series D 5½% due April 1, 1986	$ –	$ 800,000
Series E 5½% due April 1, 1989	–	3,455,000
Term bank loans	125,000,000	62,000,000
Obligations under capital leases	–	83,000
Advances under gas contracts	1,283,000	1,511,000
	126,283,000	67,849,000
Less amount included in current liabilities	218,000	1,554,000
	126,065,000	66,295,000
Unfunded pensions (Note 8)	1,965,000	1,597,000
	$128,030,000	$ 67,892,000

The Corporation called the outstanding Series E 5½% debentures for redemption on April 1, 1986. The funds for the redemption, together with funds for the final payment for the Series D 5½% debentures, were deposited with the Trustee on March 31, 1986.

During 1985, the Corporation entered into bank loan arrangements for $125,000,000 of floating rate revolving credits. As at March 31, 1986, these credits mature in fiscal years 1988 ($25,000,000) and 1989 ($100,000,000) and may be extended. The average interest rate on borrowings was 9.8% during fiscal 1986 (1985–10.8%) and 10.6% as at March 31, 1986 (1985–11.1%).

The unused lines of credit outstanding at March 31, 1986 for short term financing were $85,000,000.

8. PENSIONS

The Corporation and its subsidiaries maintain defined benefit pension plans for substantially all employees, which provide for pensions based on length of service and level of remuneration, and generally fund pensions with independent trustees in accordance with legal requirements using an actuarial investment rate of return assumption of 7%. Certain supplementary pensions are unfunded and charged to operations when paid.

Actuarial valuations are prepared at different dates for the various plans, the most recent of which are as at December 31, 1985.

Funded status as at March 31	1986	1985	1984
Actuarial market value of assets	$163,617,000	$138,204,000	$124,009,000
Accumulated accrued benefits			
Vested	137,519,000	123,586,000	111,915,000
Non-vested	2,781,000	2,381,000	1,224,000
Assets in excess of accrued benefits	23,317,000	12,237,000	10,870,000
Unearned future benefits	28,884,000	30,663,000	26,670,000
Unfunded liability	$ 5,567,000	$ 18,426,000	$ 15,800,000

The unfunded liability, which included the vested liability of $1,965,000, is being charged to operations generally over periods which approximate estimated service lives. Total pension expense for the year ended March 31, 1986 was $6,355,000 (1985–$7,649,000; 1984–$6,997,000).

The assumed rates of return used in determining the actuarial present value of accumulated accrued benefits ranged from 7½% to 10%.

In addition to pension benefits, the Corporation and its subsidiaries provide certain health care and life insurance benefits for retired employees. The costs of such benefits are charged to operations when paid, and in 1986 amounted to $517,000 (1985–$580,000; 1984–$561,000).

9. CAPITAL STOCK

	1986	1985
Authorized		
825,407 preference shares, issuable in series		
An unlimited number of common shares		
Issued		
433,745 $2.20 cumulative redeemable preference shares, Series A	$21,687,000	$21,687,000
391,662 $2.65 cumulative redeemable preference shares, Series B (1985–396,662)	19,583,000	19,833,000
	$41,270,000	$41,520,000
21,762,295 common shares	$78,357,000	$78,357,000

The Series A and B preference shares are redeemable at the option of the Corporation at $53.00 and $52.50 per share respectively. During the year ended March 31, 1986, 5,000 Series B shares were purchased on the open market for cancellation (1985–5,000; 1984–5,000).

Rothmans Investments Limited, a wholly owned subsidiary of Rothmans Inc., is the owner of record of 50.1% of the Corporation's issued common shares.

10. INCOME TAXES

The difference between a basic income tax rate of 51% (50% in 1985 and 1984) and the effective income tax rate based on income tax legislation is accounted for as follows:

	1986	1985	1984
Income taxes at basic rate	$ 32,000	$ 8,349,000	$43,822,000
Incentives	(602,000)	(1,254,000)	(6,328,000)
Investment tax credits (Note 2)	–	(4,626,000)	(2,500,000)
Alberta Royalty Tax Credit	(1,610,000)	(1,750,000)	(2,066,000)
United States oil and gas write down	277,000	530,000	–
Other–net	911,000	(246,000)	397,000
Income taxes–consolidated statement of earnings	$ (992,000)	$ 1,003,000	$33,325,000
Effective income tax rate	–%	6%	38%

Incentives include manufacturing and processing credits, inventory allowances and resource and depletion allowances, net of royalties.

Deferred income taxes primarily reflect timing differences between accounting and tax depreciation. Deferred income taxes in 1985 included the effect of the provision for the compact bottle write-off.

11. COMMITMENTS AND CONTINGENT LIABILITIES

In the normal course of business, the Corporation has commitments, including royalties payable under licensing agreements, capital expenditures and the purchase of television rights and agricultural products.

Commitments under operating lease obligations relate to sports facilities, warehouses, retail stores and offices. The following table summarizes the minimum rental payments due after March 31, 1986.

Year Ending March 31	
1987	$ 4,113,000
1988	3,186,000
1989	2,631,000
1990	2,373,000
1991	1,821,000
Thereafter to 1999	5,129,000
Total minimum rental payments	$19,253,000

There are a number of outstanding claims and legal actions involving the Corporation. In the opinion of counsel, the outcome of these matters should have no material effect on the Corporation's financial position.

12. INFORMATION PRESENTED IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN THE UNITED STATES

The unamortized excess cost of shares of subsidiary companies of $20,734,000 written off in 1986 would be treated as an unusual item, rather than as an extraordinary item, under United States generally accepted accounting principles.

For the year ended March 31, 1986, the Corporation has not capitalized interest of approximately $2,196,000 ($1,054,000 after tax) on the Toronto brewery expansion, which would have been capitalized under United States generally accepted accounting principles (1985–$500,000 and $285,000 after tax).

13. OTHER

The Information on Operations by Segment is presented on Page 25.

Chartered Accountants

Box 51
Toronto-Dominion Centre
Toronto, Ont. M5K 1G1

(416) 863 1133
Telex 06 524111
Telecopier (416) 365 8215 G3

Price Waterhouse

May 21, 1986

Auditor's Report

TO THE SHAREHOLDERS OF CARLING O'KEEFE LIMITED:

We have examined the consolidated balance sheet of Carling O'Keefe Limited as at March 31, 1986 and 1985 and the consolidated statements of earnings, changes in financial position, retained earnings and analysis of changes in operating working capital for each of the three years in the period ended March 31, 1986. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the results of operations, changes in financial position and changes in operating working capital of the Corporation for each of the three years in the period ended March 31, 1986 and its financial position as at March 31, 1986 and 1985, in accordance with generally accepted accounting principles applied, except for the change, with which we concur, in the method of accounting for investment tax credits as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding years.

Price Waterhouse
Chartered Accountants

LINES OF BUSINESS

Carling O'Keefe Limited, through its subsidiaries, manufactures and sells brewery and wine products in Canada and brewery products in Ireland. It also owns a producing oil and gas company, which operates primarily in Canada. All subsidiaries are wholly owned.

Carling O'Keefe Breweries of Canada Limited is one of three major beer companies, which together account for approximately 96% of all Canadian beer sales. The company had an average of 4,500 employees during the year and operates seven breweries in Canada, with an annual production capacity of approximately 7,920,000 hectolitres. One plant is located in each of the Provinces of Newfoundland, Quebec, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia. In Ontario, Manitoba, Saskatchewan, Alberta and British Columbia, the company and other Canadian brewers jointly own companies for the distribution of their products and pay their respective share of operating costs based on market share. In Quebec and Newfoundland, beer is distributed through independent distributors and company branches. The company manufactures and sells its own and licensed brands. Principal brands are O'Keefe, Old Vienna, Miller High Life, Miller Lite, Carlsberg, Carlsberg Light, Carling Black Label and O'Keefe's Extra Old Stock. The company has recently launched Foster's Lager in Ontario and Old Vienna Light in the Prairie Provinces. Exports of Old Vienna, O'Keefe and Cinci to the United States are distributed through Century Importers, Inc. The company owns Le Club de Hockey Les Nordiques, which operates the National Hockey League team in Quebec City and the American Hockey League team in Fredericton. The company also owns the Argonaut Football Club, which operates the Canadian Football League team in Toronto.

Jordan & Ste-Michelle Cellars Ltd. had an average of 320 employees during the year and operates two wineries with a practical storage capacity of approximately 350,000 hectolitres. One winery is located in each of the Provinces of Ontario and British Columbia. With the exception of sales through 33 company operated retail stores in Ontario, all sales are made through outlets operated by Provincial Liquor Boards. The company uses two trading styles, Jordan and Ste-Michelle. The principal brands are Maria Christina, Toscano, Spumante Bambino, Interlude and Coola Bianca, as well as Growers ciders. The company has recently entered into a joint venture to manufacture and distribute cider products for the United States market.

Star Oil & Gas Ltd. had an average of 18 employees during the year and is engaged in the exploration for and the development and production of oil and gas. The estimated proved developed and undeveloped net crude oil and natural gas liquids and natural gas reserves after royalties at March 31, 1986 were 730,000 cubic metres and 3,665,000,000 cubic metres respectively. These are located primarily in the Provinces of Alberta and Saskatchewan.

Beamish & Crawford plc had an average of 360 employees during the year and operates a brewery in Cork, Republic of Ireland with an annual production capacity of approximately 450,000 hectolitres. The Irish beer market is dominated by one beer company, which accounts for approximately 85% of the industry. The remaining market is primarily shared by Beamish & Crawford and one other brewer. Beer is distributed either through independent distributors or directly to retail outlets. Principal brands are Carling Black Label, Carlsberg and Bass.

Other income is derived from royalties under a licensing arrangement for the production and sale of Carling Black Label and from sundry investments.

The Corporation, as a non-Canadian under the Investment Canada Act, is required to obtain approval under that Act for the acquisition of any Canadian business having assets exceeding $5,000,000.

FIVE YEAR FINANCIAL SUMMARY
INFORMATION ON OPERATIONS BY SEGMENT
(IN THOUSANDS OF DOLLARS)

	1986	1985	1984	1983	1982
SALES REVENUE					
Beer–Canada	$765,022	$778,746	$824,103	$661,761	$535,329
–Ireland	67,906	54,703	45,184	48,059	47,952
Wine	54,618	57,731	59,348	58,238	48,563
Oil and gas	25,107	23,376	19,831	16,169	12,289
Consolidated	$912,653	$914,556	$948,466	$784,227	$644,133
EARNINGS					
Beer–Canada	$ 2,553	$ 4,821	$ 70,938	$ 61,881	$ 33,458
–Ireland–operations	3,991	3,333	2,105	2,146	2,094
–foreign exchange	–	–	–	(702)	(1,432)
Wine	(2,328)	3,225	5,596	5,741	3,949
Oil and gas	11,560	10,015	9,089	1,389	3,907
	15,776	21,394	87,728	70,455	41,976
Corporate income (expense)–net	(3,549)	(2,412)	676	151	–
Interest expense	(12,165)	(2,285)	(759)	(1,997)	(4,242)
Income taxes	992	(1,003)	(33,325)	(30,540)	(14,960)
Consolidated	$ 1,054	$ 15,694	$ 54,320	$ 38,069	$ 22,774
IDENTIFIABLE ASSETS					
Beer–Canada	$460,728	$393,799	$295,370	$217,740	$186,379
–Ireland	41,269	28,675	23,050	24,859	23,988
Wine	50,486	58,534	57,680	56,032	55,867
Oil and gas	76,183	73,090	66,091	60,287	63,513
Corporate	2,813	792	7,465	31,367	11,930
Consolidated	$631,479	$554,890	$449,656	$390,285	$341,677
CAPITAL EXPENDITURES					
Beer–Canada	$ 57,697	$107,548	$ 62,068	$ 23,428	$ 14,547
–Ireland	5,193	1,762	1,106	1,052	980
Wine	2,497	4,153	1,855	1,920	2,619
Oil and gas	10,901	10,994	8,771	7,024	6,972
Consolidated	$ 76,288	$124,457	$ 73,800	$ 33,424	$ 25,118
DEPRECIATION AND DEPLETION					
Beer–Canada	$ 17,175	$ 12,851	$ 9,162	$ 8,237	$ 7,106
–Ireland	798	476	446	574	539
Wine	1,709	1,529	1,419	1,335	1,194
Oil and gas	4,442	4,565	3,312	8,722	3,535
Consolidated	$ 24,124	$ 19,421	$ 14,339	$ 18,868	$ 12,374

Earnings by segment represents sales revenue, less all operating expenses other than corporate costs, interest and income taxes. Identifiable assets are those that are used in the Corporation's operations in each industry. Corporate assets comprise cash, short term investments, receivable from sale of trade marks and mortgage receivable.

FIVE YEAR FINANCIAL SUMMARY

(UNAUDITED)
(IN THOUSANDS OF DOLLARS)

	1986	1985	1984	1983	1982
EARNINGS					
Earnings from operations	$ 1,054	$ 15,694	$ 54,320	$ 38,069	$ 22,774
Extraordinary item	(20,734)	–	–	–	–
Earnings (loss) for the year	$ (19,680)	$ 15,694	$ 54,320	$ 38,069	$ 22,774
Dividends					
Preference	$ 1,996	$ 2,011	$ 2,022	$ 2,037	$ 2,046
Common					
Regular	$ 10,446	$ 10,011	$ 8,052	$ 5,658	$ 4,352
Special	$ –	$ –	$ –	$ –	$ 1,633
Earnings (loss) per common share					
Before extraordinary item	(4)¢	63¢	$2.40	$1.65	95¢
After extraordinary item	$(1.00)	63¢	$2.40	$1.65	95¢
Dividends per common share					
Regular	48¢	46¢	37¢	26¢	20¢
Special	–	–	–	–	7.5¢
BALANCE SHEET					
Current assets	$213,947	$168,333	$165,199	$163,281	$135,243
Current liabilities	162,904	147,225	113,958	102,556	84,607
Working capital	51,043	21,108	51,241	60,725	50,636
Property, plant and equipment–net	398,661	347,588	244,482	187,750	173,849
Other assets	18,871	38,969	39,975	39,254	32,585
Net assets	468,575	407,665	335,698	287,729	257,070
Long term debt	125,000	65,000	4,722	7,744	10,706
Other long term obligations	90,286	62,672	53,417	43,873	40,515
Preference shares	41,270	41,520	41,770	42,020	42,270
Common shares and retained earnings	$212,019	$238,473	$235,789	$194,092	$163,579
Current ratio	1.3	1.1	1.4	1.6	1.6
Debt to equity	33:67	19:81	2:98	3:97	5:95
Return on shareholders' equity	0.4%	5.6%	21.1%	17.2%	11.5%
Return on capital employed	7.5%	6.7%	20.5%	15.0%	12.0%
Book value per common share	$9.74	$10.96	$10.83	$8.92	$7.52

Return on shareholders' equity represents the earnings from operations divided by the average of the opening and closing balances of shareholders' equity.

Return on capital employed represents earnings from operations, before deferred income taxes and interest expense, divided by capital employed. Capital employed is the average of the opening and closing balances of shareholders' equity, interest bearing debt and other long term obligations, which includes deferred income taxes.

QUARTERLY FINANCIAL DATA
(UNAUDITED)

Summarized quarterly financial data for 1986 and 1985 (in thousands of dollars, except per share data) appear below.

	QUARTER ENDED			
1986	**JUNE 30**	**SEPT. 30**	**DEC. 31**	**MARCH 31**
Sales revenue	$241,591	$262,366	$231,761	$176,935
Gross profit	$ 76,363	$ 81,953	$ 73,652	$ 51,713
Earnings (loss) before extraordinary item	$ 1,206	$ 2,477	$ 2,680	$ (5,309)
Extraordinary item	–	–	–	(20,734)
Net earnings (loss)	$ 1,206	$ 2,477	$ 2,680	$ (26,043)
Net earnings (loss) per common share				
Before extraordinary item	$0.03	$0.09	$0.10	$(0.26)
After extraordinary item	$0.03	$0.09	$0.10	$(1.22)
1985				
Sales revenue	$263,909	$262,741	$223,082	$164,824
Gross profit	$ 93,056	$ 91,461	$ 51,058	$ 47,416
Net earnings (loss)	$ 14,482	$ 11,995	$ (7,606)	$ (3,177)
Net earnings (loss) per common share	$0.64	$0.53	$(0.37)	$(0.17)

Gross profit represents sales revenue, less production and sales taxes and raw materials and manufacturing costs.

SUPPLEMENTARY INFORMATION ON OIL AND GAS PRODUCING ACTIVITIES

(UNAUDITED)

The following unaudited supplementary information relates to the Corporation's oil and gas producing activities.

METRIC CONVERSION

The Canadian petroleum industry utilizes the metric system. The following conversion factors are given to convert metric terms to the Imperial system of units:

TO CONVERT FROM		TO		MULTIPLY BY
Cubic metres	(m^3)	Barrels	(bbl)	6.3
Thousands of cubic metres	(10^3m^3)	Thousands of cubic feet	(mcf)	35.5
Hectares	(ha)	Acres	(ac)	2.5

ESTIMATED NET QUANTITIES OF PROVED OIL AND GAS RESERVES

	YEAR ENDED MARCH 31		
	1986	1985	1984
Crude oil and natural gas liquids (10^3m^3)			
Net proved reserves at beginning of year	651	725	749
Additions from drilling	82	38	39
Revisions of previous quantities and royalties	71	(46)	(3)
Production	(74)	(66)	(60)
Net proved reserves at end of year	730	651	725
Net proved developed reserves at end of year	730	651	725
Natural gas (10^6m^3)			
Net proved reserves at beginning of year	3,912	4,032	4,114
Additions from drilling	38	231	179
Revisions of previous quantities and royalties	(180)	(246)	(165)
Production	(105)	(105)	(96)
Net proved reserves at end of year	3,665	3,912	4,032
Net proved developed reserves at end of year	2,678	2,858	2,917

The Corporation's oil and gas reserves are substantially all located in Canada. Estimates of proved developed reserves were prepared by independent evaluators and are deemed to be those reserves which, to a high degree of certainty, are considered to be recoverable at commercial rates under present production methods and current operating conditions, prices and costs. Estimates of proved undeveloped reserves include only those reserves which are expected to be recovered on undrilled lands from new wells which are virtually certain of production when drilled. Proved developed and undeveloped reserves do not include probable reserves nor possible additional reserves which may be found by extensions of presently proved reservoirs or by new discoveries on presently held properties.

CAPITALIZED COSTS

The aggregate capitalized cost and accumulated depletion of oil and gas properties, more than 80% of which was related to proved properties, were:

	YEAR ENDED MARCH 31		
	1986	1985	1984
Proved and unproved properties	$108,424,000	$ 97,773,000	$ 86,491,000
Less accumulated depletion	34,178,000	29,677,000	24,664,000
	$ 74,246,000	$ 68,096,000	$ 61,827,000

Costs capitalized in oil and gas activities

	YEAR ENDED MARCH 31		
	1986	1985	1984
Property acquisition costs	$ 2,041,000	$ 2,546,000	$ 2,162,000
Exploration costs	584,000	616,000	393,000
Development costs	8,030,000	7,576,000	6,196,000
	$ 10,655,000	$ 10,738,000	$ 8,751,000

RESULTS OF OPERATIONS FOR OIL AND GAS PRODUCING ACTIVITIES

	YEAR ENDED MARCH 31		
	1986	1985	1984
Sales revenue, net of royalties	$ 25,107,000	$ 23,376,000	$ 19,831,000
Less:			
Production costs	9,105,000	8,796,000	7,430,000
Depletion and depreciation	4,442,000	4,565,000	3,312,000
Income taxes	5,594,000	4,579,000	3,235,000
Results of operations from producing activities, excluding corporate overhead and interest costs	$ 5,966,000	$ 5,436,000	$ 5,854,000

Production costs include lifting costs, petroleum and gas revenue taxes, as well as direct administration costs. Income taxes are net of the Alberta Royalty Tax Credit.

STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH INFLOWS FROM PROVED RESERVES

	YEAR ENDED MARCH 31		
	1986	1985	1984
Future net cash inflows	$350,356,000	$417,960,000	$431,852,000
Less:			
Production costs	109,480,000	129,136,000	163,224,000
Development costs	14,950,000	16,064,000	18,697,000
Income taxes	74,801,000	98,188,000	96,488,000
Future net cash inflows, undiscounted	151,125,000	174,572,000	153,443,000
Less 10% annual discount for estimated timing of net cash inflows	89,383,000	99,426,000	99,265,000
Standardized measure of discounted future net cash inflows	$ 61,742,000	$ 75,146,000	$ 54,178,000

The estimated future net cash inflows from existing proved reserves are calculated by applying year end prices and royalty rates to forecast future production volumes. Estimated production and development costs include future costs and expenditures necessary to produce existing proved reserves, assuming current cost levels. Income taxes are estimated by applying the statutory rates in effect at year end to the pre-tax net cash inflows adjusted for known permanent differences. Provincial tax credits and royalty rebates have been deducted from income taxes.

A 10% annual discount factor has been applied to the estimated timing of future net cash inflows to determine the amount of the discount. The discount was then deducted from estimated future net cash inflows to determine the Standardized Measure of Discounted Future Net Cash Inflows.

The Standardized Measure of Discounted Future Net Cash Inflows should not be considered to represent the fair market value of the Corporation's oil and gas properties.

The following are the principal changes in the Standardized Measure of Discounted Future Net Cash Inflows.

	YEAR ENDED MARCH 31		
	1986	1985	1984
Reserve additions from drilling, net of future production and development costs	$ 4,049,000	$ 10,031,000	$ 5,197,000
Changes in prior years' reserves			
Accretion of discount	11,524,000	9,171,000	8,919,000
Prices, production and development costs	(31,267,000)	25,089,000	2,163,000
Revision of quantities and royalties	2,157,000	(6,183,000)	(1,354,000)
Sales revenue, net of production costs and petroleum taxes	(16,002,000)	(14,580,000)	(12,401,000)
Change before income taxes	(29,539,000)	23,528,000	2,524,000
Income taxes	(16,135,000)	2,560,000	3,108,000
Change after income taxes	$(13,404,000)	$ 20,968,000	$ (584,000)

The changes in the Standardized Measure of Discounted Future Net Cash Inflows are calculated before income taxes, using year end selling prices, royalties and costs.

MARKET PRICE OF SHARES AND RELATED SECURITY HOLDER MATTERS

The common shares are listed on the Toronto, Montreal, Vancouver, New York and Amsterdam exchanges, using the symbol CKB. For Canadian income tax purposes, the valuation day (December 22, 1971) value was $7.50. There were 14,687 shareholders of record as at March 31, 1986.

The $2.20 Series A and $2.65 Series B preference shares are listed on the Toronto Stock Exchange. For Canadian income tax purposes, the valuation day (December 22, 1971) value was $32.00 and $36.50 respectively. There were 1,597 and 915 shareholders of record respectively as at March 31, 1986.

	1986 FISCAL YEAR				1985 FISCAL YEAR			
	FOURTH QUARTER Jan.1-Mar. 31	THIRD QUARTER Oct. 1-Dec. 31	SECOND QUARTER July 1-Sept. 30	FIRST QUARTER Apr. 1-June 30	FOURTH QUARTER Jan. 1-Mar. 31	THIRD QUARTER Oct. 1-Dec. 31	SECOND QUARTER July 1-Sept. 30	FIRST QUARTER Apr. 1-June 30
COMMON SHARES								
Toronto Stock Exchange								
High	$16.00	$13.75	$15.25	$17.00	$15.62	$16.87	$18.37	$19.12
Low	11.75	12.37	13.25	14.50	13.62	14.50	15.50	16.37
New York Stock Exchange (United States currency)								
High	$11.25	$10.00	$11.25	$12.37	$11.62	$12.75	$14.12	$14.87
Low	8.37	8.87	9.62	10.62	10.12	11.00	11.62	12.37
Dividends per common share	12.0¢	12.0¢	12.0¢	12.0¢	12.0¢	12.0¢	12.0¢	10.0¢
PREFERENCE SHARES								
Toronto Stock Exchange								
Series A								
High	$26.50	$25.75	$25.37	$25.75	$25.00	$24.25	$24.25	$23.75
Low	23.00	23.87	23.87	23.00	23.00	22.87	22.00	22.00
Series B								
High	$30.75	$30.87	$30.75	$30.50	$30.37	$29.25	$31.00	$28.25
Low	28.25	29.37	29.37	28.00	28.25	27.75	27.75	27.00

There are no restrictions on the export or import of capital which affect the remittance of dividends, interest or other payments to non resident holders of the Corporation's securities.

Withholding taxes at the rate of 25% are imposed on the payment of dividends and interest to non-residents of Canada. Under certain tax treaties, including the Canada/United States tax treaty, such rate is reduced from 25% to 15%. Capital gains on disposals are not taxable in Canada if the United States security holder has no permanent establishment in Canada.

The Corporation, as a non-Canadian under the Investment Canada Act, is required to obtain approval under that Act for the acquisition of any Canadian business having assets exceeding $5,000,000.

FORM 10-K

Carling O'Keefe Limited common shares are traded on the New York Stock Exchange and the Corporation, therefore, files an annual report on Form 10-K with The Securities and Exchange Commission in Washington, D.C. Shareholders may obtain a copy of this report by writing to the Vice President Legal and Secretary of the Corporation.

VERSION FRANÇAISE

Si vous désirez un exemplaire de la version française du présent rapport, veuillez en faire la demande par écrit au:
Vice-président, Affaires juridiques et secrétaire général
Carling O'Keefe Limitée
79 St. Clair Avenue East, Toronto
Canada M4T 1M6

CARLING O'KEEFE LIMITED

PRINCIPAL OPERATING SUBSIDIARY COMPANIES

CANADA
Carling O'Keefe Breweries of Canada Limited
Carling O'Keefe Breweries Ontario Limited
Carling O'Keefe Breweries Western Limited
La Brasserie O'Keefe Ltée
Jordan & Ste-Michelle Cellars Ltd.
Star Oil & Gas Ltd.

REPUBLIC OF IRELAND
Beamish & Crawford plc

UNITED STATES
Century Importers, Inc.

EXECUTIVE OFFICERS OF PRINCIPAL OPERATING SUBSIDIARIES

DONALD H. TWINER
Carling O'Keefe Breweries of Canada Limited

RICHARD W. SCULLY
Carling O'Keefe Breweries Ontario Limited

ALAN N. PHIZACKLEA
Carling O'Keefe Breweries Western Limited

EDWARD J. PRÉVOST
La Brasserie O'Keefe Ltée

RICHARD B. MITCHELL
Jordan & Ste-Michelle Cellars Ltd.

ARTHUR M. DEYHOLOS
Star Oil & Gas Ltd.

R. ANTHONY HALPIN
Beamish & Crawford plc

ROBERT J. WILSON
Century Importers, Inc.

HEAD OFFICE
79 St. Clair Avenue East
Toronto, Canada M4T 1M6

AUDITOR
Price Waterhouse

SOLICITORS
Smith, Lyons, Torrance, Stevenson & Mayer

BANKERS
Bank of Montreal
The Royal Bank of Canada

REGISTRAR IN THE UNITED STATES
Morgan Guaranty Trust Company of New York

TRANSFER AGENT AND REGISTRAR IN CANADA
National Trust Company

TRANSFER AGENT IN THE UNITED STATES
The Chase Manhattan Bank, N.A.

DIRECTORS

CONRAD M. BLACK, LL.L., M.A.
Chairman of the Board & Chief Executive Officer
Argus Corporation Limited, Toronto, Ontario

SIR ROBERT CRICHTON-BROWN, K.C.M.G.,C.B.E.,T.D.
Executive Chairman
Rothmans International p.l.c., London, England

PIERRE DES MARAIS II†
President, Pierre Des Marais Inc., Montreal, Quebec

PATRICK J. FENNELL
President & Chief Executive Officer
Rothmans Inc.
Toronto, Ontario

VERNAL C. GERMAN, P.Eng.†
Company Director and Consultant
Toronto, Ontario

WILLIAM J. M. HENNING, Q.C.*
Senior Partner, Parlee
Edmonton, Alberta

THE HON. WILLIAM M. KELLY, B.A.Sc., P.Eng., M.E.I.C.
Chairman of the Board
Rothmans Inc.
Toronto, Ontario

I. LOYOLA MATTE
Company Director, Ottawa, Ontario

S. RODERICK McINNES, C.A.†
Chairman, President & Chief Executive Officer
Carling O'Keefe Limited, Toronto, Ontario

POUL J. SVANHOLM
President & Group Chief Executive
United Breweries Ltd., Copenhagen, Denmark

JAMES G. TORRANCE, Q.C.*
Senior Partner, Smith, Lyons, Torrance, Stevenson & Mayer
Toronto, Ontario

LOUISE B. VAILLANCOURT*
Company Director, Outremont, Quebec

OFFICERS

S. RODERICK McINNES
Chairman, President & Chief Executive Officer

JOHN R. BARNETT
Executive Vice President Development

J. WILLIAM JAGO
Vice President Administration

PETER JOHN YOUNG
Vice President Legal & Secretary

ALAN M. HODGE
Vice President & Treasurer

CAROL A. MUNRO
Assistant Secretary

*Member of the Audit Committee of the Board
†Member of the Pension and Compensation Committee of the Board

CARLING O'KEEFE LIMITED · ANNUAL REPORT 1986